IT 03-10
Tax Type: Income Tax
Issue: Federal Change (Individual)

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

THE DEPARTMENT OF REVENUE	)	Docket No. 02-IT-0000
OF THE STATE OF ILLINOIS	)	Tax ID No. 000-00-0000
v.	)	Tax Years 1996-1997
JOHN DOE,	)	John E. White,
Taxpayer.	)	Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: John Doe appeared *pro se*; Rickey Walton, Special Assistant Attorney General, appeared for the Illinois Department of Revenue.

Synopsis:

This matter arose after John Doe ("taxpayer" or "Doe") protested a Notice of Deficiency ("NOD") the Illinois Department of Revenue ("Department") issued to him. The NOD proposed to assess Illinois income tax based on final federal changes made to items of taxpayer's income regarding calendar years 1996 and 1997.

The hearing taxpayer requested was held at the Department's offices on Chicago, Illinois. Taxpayer testified at hearing. After considering the evidence admitted at hearing, I am including in this recommendation findings of fact and conclusions of law. I recommend the NOD be finalized as issued.

Findings of Fact:

1. During the month of September 2000, the Internal Revenue Service ("IRS") notified the Department that it had changed items of income reported on federal individual income tax returns Doe filed with it regarding calendar years 1996 and

1997. Department Ex. 1, pp. 3-4 (printout of IRS examination changes).

2. The IRS changes had the effect of increasing Doe's adjusted gross income ("AGI") for each of the two years. Department Ex. 1, pp. 3-4.

3. The notices stated that the changes were agreed. Department Ex. 1, pp. 3-4.

4. The IRS notices identified Doe's residence address for those years as being in Illinois. *Id*.

5. Following its receipt of the IRS notices, and after Doe did not file a return with the Department to timely report the final federal changes to his returns for the applicable years, and pay the resulting tax due, the Department issued an NOD to taxpayer. Department Ex. 1, pp. 1-2, 5-9.

Conclusions of Law:

When the Department introduced the Notice of Deficiency into evidence under the certificate of the Director, it presented prima facie proof that Doe was liable for the tax proposed. 35 **ILCS** 5/904; PPG Industries, Inc. v. Department of Revenue, 328 Ill. App. 3d 16, 33, 765 N.E.2d 34, 48 (1st Dist. 2002); Balla v. Department of Revenue, 96 Ill. App. 3d 293, 296-97, 421 N.E.2d 236, 239 (1st Dist. 1981). The NOD includes schedules that specifically detail the bases for the Department's calculation of the amounts of tax and interest proposed to be due. *See* Department Ex. 1, pp. 1-2, 5-9. Included within those schedules are printouts of notices the IRS sent to the Department, which list the specific changes the IRS made to the federal returns Doe filed for the years at issue. Department Ex. 1, pp. 3-4. Those IRS changes had the effect of increasing Doe's AGI by $36,195 for 1996 and by $38,300 for 1997. *Id*. As a consequence of those increases in Doe's AGI, his Illinois base and net income was increased for the same

years. 35 **ILCS** 5/202 (defining net income), 5/203 (defining base income); Department Ex. 1, pp. 1-2. The NOD assessed tax against Doe as a resident of Illinois. Department Ex. 1, pp. 1-2.

Section 506(b) of the IITA requires persons having an Illinois reporting obligation to file an amended return to notify the Department of any federal recomputation or redetermination of the person's taxable income, any item of income or deduction, income tax liability, or any tax credit. 35 **ILCS** 5/506(b). Such an amended return must be filed within 120 days after such alteration has been agreed to or finally determined for federal income tax purposes or any federal income tax deficiency or refund, tentative carryback adjustment, abatement or credit resulting therefrom has been assessed or paid. *Id*. The Department issued the NOD at issue here after it had not received a return from Doe within 120 days from the date the IRS made final changes to items on Doe's federal returns for the years at issue. Department Ex. 1.

Doe bears the burden to rebut the presumptive correctness of the Department's determinations. PPG Industries, Inc., 328 Ill. App. 3d at 33, 765 N.E.2d at 48; Balla, 96 Ill. App. 3d at 296-97, 421 N.E.2d at 239. Generally,[1] to rebut the Department's determination that a person owes tax pursuant to § 506(b), a person must establish one of the following elements:

- that the federal change to an item of income, etc., is not yet final; or
- that the federal changes proposed were challenged by taxpayer, and resolved in taxpayer's favor; or
- that the taxpayer did not, in fact, have an Illinois reporting obligation regarding such item of income, etc.

35 **ILCS** 5/506(b).

At hearing, however, Doe offered no evidence to show that he lacked an Illinois reporting obligation regarding the changes affecting his AGI. Instead, he testified that he could not remember the name of the company that employed him in 1996 and 1997, or where his employment was based. Tr. pp. 11-13. While he testified that he lived in Wisconsin during the years at issue (Tr. p. 10), he offered no documentary evidence to corroborate that testimony. Balla, 96 Ill. App. 3d at 296-97, 421 N.E.2d at 239. Nor did Doe offer any evidence to show that changes were not made, or were not final, regarding the years at issue. Rather, he testified that he had challenged, or was challenging, certain IRS determinations for a subsequent year. Tr. pp. 22, 24-25. Finally, he offered no credible documentary evidence to show that he did not, in fact, receive the income reported to the IRS, and about which items of income the IRS notified the Department.

Instead of offering proof of facts to show that the Department's determinations were wrong, Doe challenges the NOD by attacking the Department's reliance upon data sent to it by the IRS, which he calls unreliable hearsay. Tr. pp. 7, 29 (Doe). In his brief, Doe further cites to federal cases that hold that the IRS must offer evidence to support a determination that a given person actually received the income the IRS determined had been received by him. Respondent Doe's Trial Brief, pp. 2-4. Doe argues that the same reasoning should apply in this case, and that I should decide that the NOD issued to him is not entitled to a presumption of correctness. *Id*. I address each of Doe's arguments in turn.

Doe is correct that the IRS notices constituted hearsay when they were offered into evidence at hearing, but that does not mean that the Department was precluded from

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[1] This list is not intended to be exhaustive, but merely reflects the more common defenses used to rebut, or to cause the Department to reconsider issuing, an NOD based on IITA § 506(b).

considering them when deciding whether to issue the NOD here. 35 **ILCS** 5/904(b). Where a required return is not filed, the Illinois General Assembly gave the Department express statutory authority to use the best available information to determine whether any tax is due. 35 **ILCS** 5/904(b) ("If the taxpayer fails to file a return, the Department shall determine the amount of tax due according to its best judgment and information, which amount so fixed shall be prima facie correct and shall be prima facie evidence of the amount of tax due. The Department shall issue a notice of deficiency to the taxpayer which shall set forth the amount of tax and penalties proposed to be due."). Indeed, absent notification by the IRS, it would be virtually impossible for the Department to ever learn of subsequent changes to previously reported items of federal income, loss, etc., unless the person with the Illinois reporting obligation voluntarily complied with IITA § 506(b).

Again, the notices triggered the Department's decision to issue the NOD, but that is because those notices were the best information available to the Department at the time. In the same vein, the IRS notices also satisfy the Illinois Administrative Procedures Act's standard for admissible hearsay, since they constitute evidence that is "of a type commonly relied upon by reasonably prudent men in the conduct of their affairs." 5 **ILCS** 100/10-40(a).

Additionally, during pre-hearing discovery, and during the hearing, the Department established that the IRS notices were received by it in the form of computer tape, after being transmitted pursuant to an agreement between the IRS and the Department to exchange certain data. *See* Order dated 3/26/03 (granting in part and denying in part taxpayer's motion for sanctions); Tr. p. 7-8 (responding to taxpayer's

objection to the introduction of Department Exhibit 1). Both Federal and state statutes authorize such an exchange of data. 26 U.S.C. § 6103(d); 20 **ILCS** 2505/2505-65. It is clear, therefore, that the Department has undertaken to exercise its authorized power to collect data and to retain and make use of such data, where "necessary to efficient tax collection administration." 20 **ILCS** 2505/2505-65. The Department's creation of the relevant portion of such data, i.e., that portion dealing with this particular taxpayer for the years at issue, is, therefore, a Department record, and it was properly admitted at hearing, pursuant to IITA § 914. 35 **ILCS** 5/914.

In sum, not only was the Department justified in relying on the relevant IRS data when making its initial determination that Doe owed tax here (35 **ILCS** 5/904(b)), but it was also proper for a printout of such data to be offered and admitted as evidence at the hearing in this case. 35 **ILCS** 5/914; 5 **ILCS** 100/10-40(a). The notices were admissible pursuant to valid, statutory exceptions to the hearsay rule, and the contents of those notices may be given whatever probative value they have on any fact at issue. *Id.*; 35 **ILCS** 5/914. Here, I consider the notices probative of why the Department made its initial determination that Doe owed Illinois income tax pursuant to IITA § 506(b) — nothing more; nothing less. But regardless whether the IRS's notices were admitted and considered by me or not, the truth remains that it is Doe who is in the best position to know — and establish — proof of any of the facts that might rebut the Department's prima facie case. *See supra*, page 3. It is the NOD, after all, and not the data upon which the notice was issued, that is entitled to a presumption of correctness under the IITA. 35 **ILCS** 5/904(b).

I further reject Doe's argument that a Department NOD is not entitled to a

presumption of correctness unless the Department also offers some evidence to show that the taxpayer, in fact, received the taxable income at issue. Illinois law is directly to the contrary. The Illinois appellate court, in Balla, addressed that specific issue:

> Ordinarily, the taxing authority has the burden of proof regarding a taxpayer's liability to the government. (Cornett-Lewis Coal Co. v. C. I. R. (6th Cir. 1944), 141 F.2d 1000.) For example, the taxing authority bears the burden of proving that the taxpayer actually received income (Thomas v. C. I. R. (6th Cir. 1955), 223 F.2d 83), and that such income is properly subject to taxation (Miller v. United States (7th Cir. 1961), 296 F.2d 457). ***The Illinois legislature, in order to aid the Department in meeting its burden of proof in this respect, has provided that the findings of the Department concerning the correct amount of tax due are prima facie correct. (Ill.Rev.Stat.1979, ch. 120, par. 9-904(a).) When the taxpayer introduces credible evidence to the contrary, the burden is again placed on the Department to prove its contentions by a preponderance of the evidence.*** Goldfarb v. Department of Revenue (1952), 411 Ill. 573, 104 N.E.2d 606.

Balla, 96 Ill. App. 3d at 295, 421 N.E.2d at 238 (emphasis added).

The principle that the Department satisfies its initial burden of proof by introducing its Notice of Deficiency — and nothing more — was recently reaffirmed in PPG Industries, Inc. There, a taxpayer challenged the Department's use of a formula to calculate reversionary sales attributable to Illinois. The Department used a formula in the absence of documents that would have revealed the actual gross receipts from such sales. PPG Industries, Inc., 328 Ill. App. 3d at 33, 765 N.E.2d at 48. At the administrative hearing, taxpayer offered the testimony of two employee witnesses, one of whom said that documents were offered to the Department auditor, but that they were never actually reviewed by her. *Id*., at 31, 765 N.E.2d at 46-47. The trial court considered that testimony sufficient to show that Department's audit was unreasonable in that respect,

and that the Department's determination of tax due on that particular point was not worthy of being presumed correct. The appellate court reversed, stating:

> The Department argues that, by properly making corrections on reversionary sales, it has established a *prima facie* case and that PPG failed to rebut the presumption by competent evidence. Under Illinois law, the Department claims that, once the burden is placed on the taxpayer, it has the responsibility to introduce evidence at the hearing to prove the legitimacy of its claim. *Balla v. Department of Revenue,* 96 Ill.App.3d 293, 296, 51 Ill.Dec. 728, 421 N.E.2d 236 (1981). Further, the Department claims that PPG had the burden of overcoming its *prima facie* case through documentary evidence, meaning books and records, and not mere testimony. *Jefferson Ice Co. v. Johnson,* 139 Ill.App.3d 626, 632, 94 Ill.Dec. 249, 487 N.E.2d 1126 (1985); *Mel-Park Drugs, Inc. v. Department of Revenue,* 218 Ill.App.3d 203, 217, 160 Ill.Dec. 707, 577 N.E.2d 1278 (1991); *A.R. Barnes & Co. v. Department of Revenue,* 173 Ill.App.3d 826, 832, 123 Ill.Dec. 410, 527 N.E.2d 1048 (1988); *Masini v. Department of Revenue,* 60 Ill.App.3d 11, 15, 17 Ill.Dec. 325, 376 N.E.2d 324 (1978); *Copilevitz v. Department of Revenue,* 41 Ill.2d 154, 157-58, 242 N.E.2d 205 (1968). Based on these cases, the Department claims that the testimony of [taxpayer's employee witnesses] is insufficient to overcome its *prima facie* case that the reversionary sales were properly computed based on the formula. We agree.
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> … [W]e determine that the Department established a *prima facie* case that its reversionary sales calculations were correct. As noted above, "[a] corrected return as prepared by the Department is * * * deemed *prima facie* correct." *Jefferson Ice Co.,* 139 Ill.App.3d at 630, 94 Ill.Dec. 249, 487 N.E.2d 1126. Further, the law establishes that, "[t]o overcome the Department's *prima facie* case, a taxpayer must present more than its testimony denying the accuracy of the assessments, but must present sufficient documentary support for its assertions." *Mel-Park Drugs, Inc.,* 218 Ill.App.3d at 217, 160 Ill.Dec. 707, 577 N.E.2d 1278.

PPG Industries, Inc., 328 Ill. App. 3d at 33-34, 765 N.E.2d at 48-49.

Together, Balla and PPG stand foursquare for the proposition that the

Department's prima facie case is made once it has introduced a copy of the NOD, under the certificate of the Director. The statutory presumption of correctness that attaches to the Department's prima facie case is rebutted after — and only after — a taxpayer introduces documentary evidence, closely associated with its books and records, to show that the Department's determinations are incorrect. PPG Industries, Inc., 328 Ill. App.3d at 33, 765 N.E.2d at 48; Balla, 96 Ill. App. 3d at 295, 421 N.E.2d at 238. Doe offered no such documentary evidence here. He has, therefore, failed to rebut the presumed correctness of the Department's determination that he owed Illinois income tax in the amount set forth in the NOD.

Conclusion:

I recommend that the Director finalize the Notice of Deficiency as issued, and the tax proposed be assessed, with interest to accrue pursuant to statue.

Date: 8/11/2003

John E. White
Administrative Law Judge